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THE U.S. ECONOMY: BRIGHTER DAYS AHEAD

by
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In last month's assessment of the economic outlook, we noted that despite a disappointing first half, a growing number of positive signals suggested that the economy was poised for a turnaround. With the release of more complete data for August and September, the signs of improvement are becoming unmistakable. Moreover, indicators which foreshadow movements in overall economic activity, including the index of leading indicators, are pointing to renewed strength in the months to come. The leading index, designed to predict economic activity six months in advance, rose by 0.7 percent in August, following a similar increase in July, for the seventh increase this year. The series is now 1.1 percent above its 1984 peak. Other indications of stronger growth in the months ahead, discussed in greater detail below, include manufacturers' orders, building permits, and employment.

Recent Recovery Experience

Now entering its fourth year, the current recovery seems to have already become one of the three longest recoveries in postwar history, ranking behind the 1960 and 1975 expansions. Moreover, on the inflation and job creation fronts, the current episode is performing better than the 1960 and 1975 recoveries. Although civilian employment rose faster during the third year of the 1975 recovery, this was accompanied by double digit rates of growth in consumer prices. And, while the 1960s was a period of low inflation, job creation was significantly slower than this time around.

While concern continues to be expressed regarding the weakness experienced during the first half of 1985, Table 1 shows that compared to the previous five upturns which lasted this long, real gross national product rose at an average rate during the third year of recovery. In fact, a closer look at the data reveals that had it not been for our deteriorating trade balance, real GNP growth would have been substantially stronger than average. Most components of GNP, with the exception of net exports and

TABLE 1
SELECTED ECONOMIC INDICATORS
RECOVERY EXPERIENCE[1]
(percent)

	First Year	Second Year	Third Year
Real GNP			
Average	4.3	5.4	4.3
82:3 to 85:2	0.8	6.7	4.2
Consumption			
Average	3.2	4.2	3.8
82:3 to 85:2	2.4	5.8	4.2
Nonresidential Investment			
Average	2.7	7.5	6.4
82:3 to 85:2	−2.3	15.5	13.7
Equipment			
Average	3.5	9.5	7.1
82:3 to 85:2	−0.4	20.3	13.7
Structures			
Average	1.7	4.4	4.9
82:3 to 85:2	−6.3	4.6	13.7
Residential Investment			
Average	10.1	5.5	4.9
82:3 to 85:2	17.8	33.4	1.6
Exports			
Average	2.9	9.9	8.2
82:3 to 85:2	−10.0	2.5	0.7
Imports			
Average	5.4	9.9	7.5
82:3 to 85:2	−2.4	22.4	17.4
Industrial Production			
Average	5.7	7.5	6.9
82:3 to 85:2	−0.6	13.3	5.8
Civilian Employment			
Average	1.0	2.7	2.3
82:3 to 85:2	−0.3	3.8	2.9

[1]First year is average of first four quarters of recovery compared to recession trough. Second and third years are four-quarter averages compared to previous period.

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residential investment, grew at rates significantly above average in the twelve months ending with the second quarter. Moreover, once the GNP benchmark data revisions are completed at year-end, growth will likely be shown to have been even stronger. Due to the heretofore faulty estimation of investment in computers, the revision is anticipated to add as much as $86 billion to total GNP in 1984.

Consumer Spending: Domestic Autos

The flash estimate of third quarter GNP anticipates a 2.8 percent annual rate increase over the second quarter. Led by spending on automobiles, the consumer sector continues to be the major source of strength. Domestic car sales reached an annual rate of 9.7 million units in August, a seven year high. This was followed by another record in September as sales for the month averaged 11.3 million units, bringing the average for the third quarter to 9.5 million. This will be reflected in a strong showing for overall consumer spending during the quarter. In fact, the Department of Commerce anticipates that, once the numbers are all in, consumer and government spending will be the only components of GNP showing increases during the third quarter; investment and net exports are expected to remain flat.

While this is good news for the quarter just ended, and may even lead to an upward revision of the data later this month, it could diminish consumer durable spending during the fourth quarter. The surge in car buying was in response to aggressive marketing efforts, particularly below-market financing. Those incentives have come to an end now and the fourth quarter begins with the introduction of the higher-priced 1986 model year cars. Industry estimates place the average price increase for 1986 models, when account is taken of higher financing charges, at nine percent. While General Motors and Ford have already introduced a below-market financing plan for certain 1986 models and other automakers are expected to follow suit, buyers may still balk at the 1986 price increases. Further, it is likely that the car buying spree of the past few months may have cut into fourth quarter sales. The result is likely to be a depressed fourth quarter for spending on consumer durables.

Housing

Data on housing and construction are mixed. While total construction spending increased strongly in August, this was from a depressed July level. Sales of existing homes jumped by nine percent in August and are now 24 percent higher than they were in August 1984. Although the monthly growth rate in sales of new single-family homes is lagging behind the growth in sales of existing homes, it remains 26.5 percent above its year-ago level. As a result, the surge in existing home sales should continue to feed into new home sales and housing starts in the coming months. Housing starts posted an increase in August, rising by 6.2 percent to an annual rate of 1.75 million units. This places the average for the first two months of the quarter at only 1.7 million units—a disappointing outcome given recent improvements in housing affordability. The National Association of Realtors' Affordability Index reached 94.8 in August, its highest level in six years. This reading of the index indicates that a median income family has 94.8 percent of the qualifying income necessary to buy a median priced resale home with an 80 percent conventional mortgage. The strong sales performance for existing homes, continued affordability improvements, low housing inventory, and building permits which have remained in the 1.7 million to 1.8 million unit range during the past four months, presage added strength for the housing industry.

Exports and Imports

An encouraging development has become evident in the data for the foreign sector. During the past nine months the rate of growth in U.S. imports of goods and services has slowed markedly (see Chart 1). While this performance mirrors the slowdown in the overall economy, other factors seem to be at work as well. Some analysts point to the fact that the slowdown in import growth may be tied to inventory problems. As businesses attempt to keep a handle on inventories they are finding that they can do so more successfully by buying from domestic sources whose lead times are shorter and delivery schedules more flexible.

CHART 1
REAL IMPORTS OF GOODS AND SERVICES
(year-ago percent change)

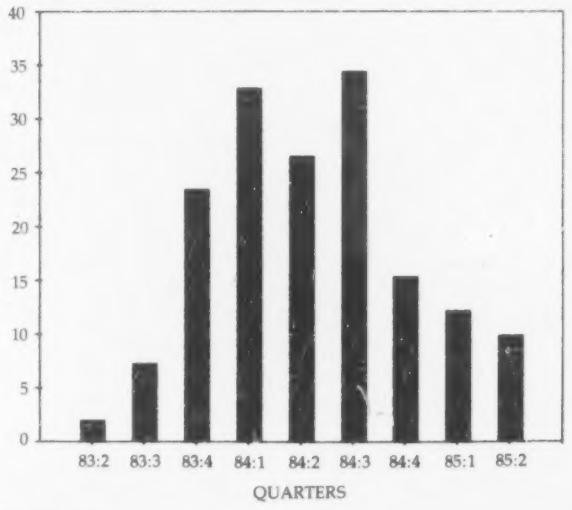

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TABLE I
UNITED STATES ECONOMIC OUTLOOK 1984-1987
Prepared by the U.S. Chamber of Commerce
Percent change from previous period at a seasonally adjusted annual rate

	QUARTERS									YEARS			
	Actual		Forecast							Actual	Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	87:1	1984	1985	1986	1987
GROSS NATIONAL PRODUCT													
Real GNP	0.3	1.9	2.8	4.1	3.9	4.0	3.6	3.9	4.4	6.8	2.5	3.7	4.0
Consumption	5.2	4.9	4.8	2.6	3.0	2.2	2.3	2.1	2.8	5.3	4.2	2.9	2.2
Residential Investment	5.5	6.1	5.8	4.1	9.5	1.5	0.7	3.6	3.0	12.2	1.8	4.8	-2.4
Business Fixed Investment	-1.5	14.4	0.3	1.9	8.0	6.3	8.8	8.6	7.8	19.8	6.6	6.1	7.3
Equipment	-5.6	16.7	0.5	2.2	8.7	7.3	10.0	9.0	7.7	21.5	6.1	6.8	7.0
Structures	9.8	8.8	-0.2	1.2	6.2	3.9	5.8	7.5	8.0	15.6	8.7	4.2	8.0
Exports	-8.9	-15.2	4.7	3.8	5.8	7.8	10.0	13.5	17.1	4.7	-3.8	5.2	18.3
Real Net Exports (72$B)	-33.8	-34.2	-34.2	-35.3	-34.2	-32.9	-30.2	-26.7	-23.4	-15.0	-32.9	-31.0	-11.0
Imports	32.2	-0.7	4.5	5.7	2.0	3.2	1.8	3.0	6.5	27.0	7.7	3.1	3.9
Government Purchases	0.6	-0.3	5.1	5.9	5.5	4.4	4.1	2.4	1.9	3.5	6.9	4.6	2.1
Real Final Sales	-0.3	4.6	4.0	2.4	4.1	3.0	3.7	3.7	4.0	3.0	3.4	3.5	3.7
Industrial Production	0.7	2.0	2.4	6.1	5.3	6.0	5.6	6.5	7.2	10.6	2.8	5.1	6.5
Change in Business Inventories (72$B)	19.1	8.3	3.8	10.9	10.2	14.1	13.9	14.5	16.0	24.8	10.5	13.2	18.5
New Car Sales (total, mill.)	11.3	11.5	12.8	11.8	12.0	12.0	12.0	12.0	12.1	10.5	11.8	12.0	11.6
New Domestic Car Sales (mill.)	8.5	8.2	9.7	8.6	8.7	8.5	8.4	8.4	8.4	8.0	8.7	8.5	8.0
New Housing Starts (total, mill.)	1.8	1.8	1.8	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.7
EMPLOYMENT, WAGES AND PRICES													
Civilian Unemployment Rate (%)	7.3	7.3	7.1	6.9	6.7	6.6	6.5	6.4	6.2	7.5	7.2	6.6	5.8
Compensation	5.0	3.3	3.8	3.8	4.7	4.5	4.5	4.7	5.2	4.2	3.9	4.3	5.0
Productivity	-3.3	1.1	-0.1	1.8	1.1	1.3	1.0	1.2	1.4	2.7	0.1	1.1	1.2
Unit Labor Costs	8.3	2.1	3.9	2.1	3.6	3.2	3.6	3.5	3.8	1.4	3.9	3.2	3.8
Consumer Price Index	3.3	4.2	2.7	3.8	4.3	4.3	4.6	4.7	5.1	4.3	3.5	4.1	5.0
Implicit GNP Deflator	5.4	2.6	3.1	3.3	3.2	3.5	3.6	3.8	4.6	3.8	2.7	3.3	4.3
Prime Interest Rate (%)	10.5	10.2	9.5	9.5	9.5	9.3	9.3	9.4	9.4	12.0	9.9	9.4	9.7
3-mos. Treasury Bill Rate (%)	8.2	7.5	7.1	7.0	7.0	6.8	6.9	7.0	7.1	9.5	7.4	6.9	7.4
Corporate Bond Rate (%)	12.3	11.6	11.0	10.8	10.5	10.2	10.0	9.8	9.7	12.7	11.4	10.1	9.7
Profits from Current Production ($B)*	207.0	214.9	209.0	216.1	217.9	225.1	227.3	233.8	243.5	195.9	211.8	226.0	302.4
GOVERNMENT FISCAL POLICY ($B)**													
Unified Receipts										666	725	790	860
Unified Outlays										842	920	980	1045
Unified Deficit										-176	-195	-190	-185

*After-tax corporate profits with inventory valuation and capital consumption adjustments.

**Unified budget figures on a fiscal year basis.

SOURCE: U.S. Chamber of Commerce, Forecasting Section, using the Washington University macroeconometric model of the U.S. economy.

FORECAST ASSUMPTIONS

This month's forecast contains the Commerce Department's revision to the National Income and Product Accounts for the second quarter of 1985. It continues to take into account all the provisions of previously enacted legislation, including indexation of personal income tax rates. Congress is assumed to enact a deficit reduction package which results in a static reduction in federal government outlays of $44 billion in 1986 and $68 billion in 1987. The nation's money supply, as measured by M(1), rises by 9 percent in 1985, 8.5 percent in 1986 and 6.9 percent in 1987. The federal minimum wage remains at $3.35 per hour throughout the forecast interval. The price of a barrel of imported crude oil averages $25 in 1986 and $23 in 1987 compared to $28.9 in 1984. The trade-weighted exchange value of the dollar rises 2.6 percent this year on a year-over-year basis. During 1986, it falls by 21 percent, but rises 2.1 percent in 1987.

Unfortunately, however, the performance of U.S. exports leaves a great deal to be desired. Even as import growth has slowed, the net exports gap has widened because export growth has slowed as well. Excluding the foreign sector from measured GNP shows that domestic demand has remained remarkably strong, rising by 3.1 percent during the second quarter of this year over its year-ago level, while total GNP rose by only 2.3 percent over the same period.

This month's forecast assumes a continued improvement in the trade balance. After growing by 27 percent last year, real imports are expected to rise by only 7.7 percent this year, 3.1 percent in 1986, and 3.9 percent in 1987. Real exports are also anticipated to recover, leading to a reduction in real net exports. This outcome is based on optimistic assumptions regarding the value of the U.S. dollar in foreign exchange markets. The weighted average exchange value of the dollar is estimated to decline by 25.6 percent by the last quarter of 1987 compared to its peak during the first quarter of this year.

Our assumption regarding the decline in the value of the dollar is based on an analysis of economic fundamentals rather than the impact of the announced foreign exchange market intervention. In fact, the dollar's value declined by 12 percent between February and September 1985, prior to the intervention announcement. The explanation lies with the apparent synchronization of economic performance and prospects here and abroad. During 1983 and 1984, not only was the U.S. recovery substantially stronger than in Europe and Japan, but prospects for a significant upturn abroad were meager.

During the past year, however, the economies of our major trading partners have strengthened. Industrial production rose by 4.1 percent in Canada, 4.5 percent in West Germany, 5.9 percent in Japan, 5.8 percent in Sweden, and 4.5 percent in the United Kingdom, compared to 1.1 percent in the United States. Moreover, although real interest rates (three month interbank rates adjusted for consumer price increases), fell in eight of the 12 largest economies between mid-1984 and mid-1985, the most rapid decline occurred in the United States. In mid-1984, real interest rates in the United States were on a par with Great Britain's and lower than only Australia's and Canada's. By the middle of this year, most of the major economies—Australia, Sweden, Italy, Canada, Great Britain, Japan, Holland, and France—had higher real interest rates than the United States. Stronger growth and higher real rates of return abroad would tend to reduce the attractiveness of dollar-denominated assets and contribute to the decline in the dollar's value. This trend is expected to continue, particularly since the late September announcement by the industrial nations included a pledge on the part of our trading partners to further stimulate their economies.

Despite the efforts of the industrialized nations to push down the value of the dollar through coordinated intervention in foreign exchange markets, we do not believe that the intervention itself will be responsible for the dollar slide. Foreign exchange intervention is notorious for its ineffectiveness. History is replete with cases of unsuccessful intervention episodes whose only result, in the last analysis, is to cost government treasuries billions of dollars while currency values, as expected, continue to respond to economic fundamentals. To be sure, intervention can be shown to have a limited, short-run impact, but in the long run, economic fundamentals will always prevail.

In the past, foreign exchange intervention was geared toward moving currency values in the *opposite* direction of their natural tendencies, i.e., attempts were made to stop a currency's depreciation, for instance. Now, efforts at lowering the value of the dollar come at a time when it is already declining on its own accord. If, as we believe, economic fundamentals were already such that the dollar was on a downward trend, intervention will accelerate that decline.

The improvements in the U.S. trade balance that will be brought about by a depreciation in the value of the dollar will not be felt immediately. History shows that the lag between changes in currency values and net exports is sometimes as much as two years long. As a result, export growth will not accelerate markedly until 1987.

Business Investment

In spite of the unprecedented strength of business investment during the past three years, the outlook for this sector is frought with uncertainty. In the short run, low capacity utilization and poor profits performance are likely to sap some of the sector's previous vigor. The capacity utilization rate inched up one-tenth of a percentage point last month to 80.5 percent, still below the 82 percent recovery peak reached last year. And corporate profits, though improved during the past quarter, are anticipated to post a weak showing during the third quarter. As a result, the Department of Commerce has estimated that third quarter business investment will show almost no growth. The fourth quarter, however, should show an improvement. Automakers expect a 3.7 percent increase in output during the fourth quarter aimed at restocking inventories and shipping new models. Industry estimates are that about eight million cars will be built in 1986.

Although shipments of nondefense capital goods increased in August, surveys continue to show a scaling down of investment plans. A recent Conference Board survey of the nation's largest manufacturing corporations showed a 4.5 percent decline in new appropriations during the second quarter and a sharp decline in projected new investment for 1985. We expect that business fixed investment will rise by 6.8 percent this year compared to almost 20 percent in 1984.

On a more positive note, manufacturers' orders rose by 0.9 percent in August and the National Association of Purchasing Management, in its monthly survey, reported strong growth during September. The Association's composite index surged last month to 51 percent, the first reading above 50 percent in nine months. When the index, which is based on such indicators as new orders, production, speed of suppliers filling orders, inventories, and employment, exceeds 50 percent, it is viewed as an indication of economic expansion. Further, the percentage of survey respondents who said that production had improved during September, increased for a third consecutive month, reaching 23 percent compared to only 14 percent in July.

Moreover, several major industrial sectors still require new spending on efficiency-improving plant and equipment in order to effectively compete against foreign producers in domestic as well as international markets. Also, the depreciation of the U.S. dollar will improve the competitiveness of traditional export firms as well as open up new export opportunities for other industries and firms. As a result, business investment is expected to continue to be a growth sector.

Conclusion

The best indication of the underlying strength of the nation's economy continues to be its remarkable ability to create new jobs. During the past 34 months, payroll employment has risen by 8.5 million, an average of 250,000 new jobs each month. With the leading indicators, new manufacturing orders, and building permits all pointing up, real GNP is expected to rise by 4.1 percent during the year's last quarter, averaging a 2.5 percent increase for the year as a whole. During 1986, the economy is expected to grow at over 3.5 percent per quarter (annual rates), posting a 3.7 percent increase for the year.

The major risk to the outlook is the uncertainty surrounding threats of tax reform. Tax reform has certainly become a major threat to U.S. business investment and is probably having a strong influence on the scaling down of investment plans. In the July/August issue of ECONOMIC OUTLOOK we reported that analysis of the so-called Treasury II tax reform proposal showed that less generous depreciation allowances and repeal of the investment tax credit would so increase the rental price of investment in producers' durable equipment that the net result would be to offset the incentives resulting from a reduction in the statutory corporate tax rate. Now, the House Ways and Means Committee has unveiled another proposal whose treatment of depreciation is even worse than under Treasury II, essentially returning depreciation lives to the Asset Depreciation Range in effect prior to the enactment of the Economic Recovery Tax Act in 1981.

Tables 2 and 3 compare the impact on the U.S. economy of the House Ways and Means proposal. The rental price of investment in business equipment, residential building, and consumer durables is expected to rise significantly, with investment in producers' durable equipment and single-family housing bearing the brunt of the increase (see Table 2). As a result, equipment investment is anticipated to be $91.5 billion lower by 1990 (five year cumulative loss), than would have been the case under present law. Total housing starts are expected to be lower

TABLE 2

IMPACT OF HOUSE WAYS & MEANS PROPOSAL ON THE RENTAL PRICE OF INVESTMENT

(Percentage Difference from Base)

	Years from Implementation				
	1	2	3	4	5
Business Capital					
Equipment	15.4	15.3	14.9	14.7	14.4
Structures	0.5	−1.0	−1.5	−3.0	−3.5
Residential Buildings					
Single Family	8.2	9.0	8.4	7.0	6.4
Multi Family	6.6	5.9	5.4	4.1	2.8
Consumer Durables	1.4	1.4	1.0	0.5	0.5
Inventories	1.7	0.0	−4.0	−6.1	−11.1

Source: Washington University Macroeconomic Model

TABLE 3

IMPACT OF HOUSE WAYS & MEANS PROPOSAL ON THE U.S. ECONOMY

	Years from Implementation					Cumulative
	1	2	3	4	5	Impact
GNP						
Billions of 72$[1]	−6.5	−19.2	−30.4	−43.9	−58.0	−158.0
Percent[2]	−0.4	−1.1	−1.7	−2.4	−3.1	
Consumption						
Billions of 72$	1.4	−2.7	−8.2	−16.4	−27.3	−53.2
Percent	0.1	−0.2	−0.7	−1.4	−2.2	
Nonresidential Investment						
Billions of 72$	−3.8	−12.4	−20.7	−29.1	−35.8	−101.8
Percent	−1.7	−5.5	−9.3	−12.4	−14.9	
Equipment						
Billions of 72$	−3.6	−11.3	−18.7	−26.1	−31.8	−91.5
Percent	−2.2	−7.0	−11.7	−15.3	−18.0	
Structures						
Billions of 72$	−0.4	−1.2	−2.0	−3.0	−4.1	−10.7
Percent	−0.6	−1.9	−3.2	−4.7	−6.5	
Residential Investment						
Billions of 72$	−4.8	−6.6	−5.9	−5.6	−5.9	−28.8
Percent	−7.3	−10.1	−9.4	−7.9	−8.0	
Exports						
Billions of 72$	−0.1	−1.0	−2.3	−3.8	−5.6	−12.8
Percent	−0.1	−0.7	−1.6	−2.6	−3.7	
Unemployment Rate						
Percentage Point Difference	0.3	0.6	0.8	1.3	1.6	
Housing Starts						
Millions of Units	−0.3	−0.2	−0.2	−0.2	−0.2	−1.2
Percent	−13.8	−12.6	−10.9	−10.5	−11.5	
Domestic Car Sales						
Millions of Units	−0.1	−0.2	−0.3	−0.5	−0.7	−1.8
Percent	−1.6	−4.4	−5.7	−9.1	−12.7	

[1]Difference from base in real (1972) dollars.

[2]Percent difference from base.

Source: Washington University Macroeconomic Model

by 1.2 million units over the five year period. The impact on gross national product is substantial. By 1990, real GNP would be 3.1 percent lower and the unemployment rate would be 1.6 percentage points higher than would otherwise have been the case (see Table 3).

This proposal is only a recommendation of the House Ways and Means Committee staff and will undergo many modifications before a final tax reform bill is enacted. As the legislative process continues, the U.S. Chamber of Commerce will work hard to ensure that the legislation which finally emerges will enhance rather than hamper capital formation and economic growth.

Hopefully, Congress and the Administration will either devise an alternative pro-growth tax reform package or drop the entire effort. It would be tragic if the tax reform concept which could have a very positive impact on future U.S. economic growth is so distorted as to turn into an instrument of economic destruction.

AMERICAN AGRICULTURE AT THE CROSSROADS

by
Rajni Bonnie Ohri

American agriculture is considered one of the most successful examples of agricultural development in the world. Agricultural industries, from farming to food processing to the retailing of farm products, constitute the largest sector of the U.S. economy, accounting for 20 percent of gross national product. The 2.5 percent of the civilian labor force involved in agriculture produce enough to feed the entire domestic population and still account for over 20 percent of our total export earnings. Today, the U.S. is the largest agricultural exporter in the world.

Despite these measures of success, the U.S. agricultural economy is going through its most difficult period since the Great Depression, and the problems there are having important repercussions on the rest of the economy. With commodity prices depressed, farmland values plummeting, and export markets shrinking, the economic viability of many farmers is imperiled. Although financial stress among farmers has grown in terms of incidence and severity during the 1980s, less than ten percent of the nation's 2.4 million farmers are actually insolvent or on the verge of bankruptcy. Indeed, according to the Department of Agriculture, 83.4 percent of U.S. farms are financially sound. The problem, however, is centered among middle-sized commercial farmers who hold a disproportionate share of the nation's farm debt. Their solvency is directly linked to the health of rural America where banks, businesses, farm suppliers, and local governments rely on the farmers for their primary market.

Farm Difficulties are Far Reaching

By any standard, the past four years have been a time of unprecedented pressure on the prices of a wide range of basic commodities. Although the 1981-82 recession lowered commodity prices 10 to 35 percent, most of these declines were reversed during the initial stages of the current expansion. By mid-1984, however, the commodity price indexes began to decline once again, with prices 15 percent lower at the end of 1984 than at the peak reached during this expansion. The steep rise in the U.S. dollar, the sluggish world recovery, and the unexpectedly good agricultural harvests worldwide have provided the main impetus to the decline in commodity prices.

This catastrophic price situation has left U.S. farmers in a difficult position. Domestic markets are not large enough to consume their bumper crops and surpluses are being added to massive government stockpiles of unsold agricultural commodities from previous years. These large increases in supply relative to demand are exerting additional downward pressure on farm prices. Corn is now selling for $2.32 per bushel down from $3.36 in June 1984; soybeans which sold for $8.12 per bushel in May 1984 have sunk to $5.22. Thus, the current farm problem is one of overproduction (leading to lower commodity prices and lower farm income) which becomes acute in the agricultural sector because one year's mistakes are stored and added to those of the next. In 1981, for instance, U.S. farmers produced a record 15.6 million bales of cotton, but only 11.8 million were sold. Carry-over stocks from 1981 have been plaguing the cotton market ever since. In 1983, cotton production was down to 7.7 million bales and demand was up to 12.7 million, but because the year began with 8 million bales in storage, cotton supply exceeded demand by almost 25 percent. Today, the price of cotton is about what it was in 1976.

When foreign demand also declines, the cumulative effects of overproduction become especially painful. Roughly four out of ten acres are planted for foreign sale. Farm exports, which totaled $7 billion in 1970 rose to $44 billion in 1981. But exports have fallen off since then and are estimated at $38 billion this year. Sixty percent of the wheat, 50 percent of the soybeans, and 33 percent of the corn crops grown by U.S. farmers are exported. If foreign customers fail to buy, as has lately been the case, there is nowhere for the crops to go but into storage, because the U.S. already has all the food it needs. As a result, many farmers with excess supply will turn over their crops to government stockpiles.

The crop surpluses have also taken their toll on farm income. Agricultural analysts estimate that the falling commodity prices could reduce net farm income to $22 billion this year, 36 percent less than what it was in 1984. And as farm prices and incomes fall, so will the value of farm assets, including land.

The farmers' difficulties are also hurting nearly all businesses that service them. The food and fiber industry,

the economy's largest sector, employs about 22 million workers in various agribusinesses. The Federal Reserve Bank of Kansas reports that one-fifth of nonfarm businesses in rural communities are experiencing financial stress. Local merchants claim that farmers are buying less machinery, fertilizer, gasoline, and pesticides. Excess supply can be seen most dramatically at the tractor and combine-making plants of firms such as John Deere, which are operating at only 55 percent of capacity, or in the unused processing mills of Archer Daniels Midland, one of the world's largest food companies. Steiger Tractor Inc., which has lost over $5 million on sales of $66 million this year, has had to cut its staff and curtail operations. Local governments (especially in Nebraska and Iowa) are also pinched. With farm income depressed and declining land values reducing property assessments, revenues are drying up and public services are being curtailed.

Outdated Farm Policies

Part of the current farm problem can be traced to the present federal farm programs which originated in the 1930s as the government's response to persistent economic problems in the sector. In 1930, 22 percent of the labor force was employed in farming and produced 9 percent of the national income. Now, the farm sector employs less than 2.5 percent of the U.S. civilian labor force and generates 2.6 percent of the national income. Farming has become an increasingly specialized, capital-intensive, high-technology business. Between 1930 and 1980, farm production grew by 140 percent while employment in agriculture declined by 80 percent. The increase in labor productivity and in turn, farm family income, was achieved through improved technology and an increase in the use of land and capital.

Throughout their history, farm programs have reflected the notion that farm-income problems are caused by *temporary* imbalances in supply and demand. Thus, there has been a succession of short-run government programs designed to deal with the economic conditions in agriculture at the time legislation was written. These short-run responses have been at the expense of an integrated farm policy that would facilitate long-term adjustments to the forces of change generated by new technology and market conditions. Today's agriculture programs have the dual objective of price stability and income enhancement. In their simplest form, these programs have established minimum support prices through the use of crop loans, direct payments, and direct purchases of products, and are supplemented by various types of voluntary (subsidy-induced) or mandatory supply reduction programs.

Farmers' income is subsidized in two ways. The first is to peg income to so-called loan rates (a target price for the product, not an interest rate), which guarantee that when prices fall below a certain level the government will buy the crops. In effect, the loan rate is a minimum, government guaranteed price. The second is through deficiency payments, which are direct cash subsidies to prop up farmers' incomes. The deficiency payments are pegged to pre-set "target prices," which assure farmers the income they would have received if market prices were at target levels.

In addition, farmers receive several other benefits from the government, such as government subsidized interest rates, federally funded farm research programs, and special tax provisions. Farming also benefits from price boosting import tariffs and quotas, marketing orders, resource conservation programs, customs revenues and food assistance sent abroad. Yet even at this elevated level of government support, segments of farming are suffering.

In 1981, when Congress enacted the current farm bill, it was looking back on one of the most prosperous decades that American farmers had ever experienced. Prosperity on the farm meant relatively little spending on farm programs: federal farm spending averaged about $3 billion a year prior to 1981. Farmers' overseas markets were expanding rapidly and farmers could sell almost everything they produced. If anything, the problem was one of shortages, not surplus.

Between 1981 and 1985, however, total federal spending on farm programs skyrocketed to over $60 billion. Several factors led to this increase: inflation slowed, reducing commodity prices; the global recession lowered demand worldwide; and the value of the dollar soared, raising the prices of American farm products and thus reducing exports. In addition, two years of bumper crops worldwide created global surpluses and placed additional downward pressures on prices. In fiscal 1983, federal government outlays for farm price and income support programs totaled $18.9 billion, an increase of $12.3 billion in two years. To this must be added another $9.4 billion worth of payment-in-kind (PIK) commodities committed in 1983 to compensate farmers for reducing their crop acreage in order to reduce inventories. These programs cost taxpayers almost $12,000 per farm. And in 1985, federal spending is already estimated at nearly $17 billion. Thus, while federal expenditures have been curtailed in many domestic program areas, the cost of farm programs has exploded.

There are several significant problems with these programs. First, they are expensive – the cost of agriculture programs in 1981 was $4 billion, rising to $12 billion in 1982 and $28 billion in 1983. Second, the minimum price established by U.S. agricultural price support programs are, at times, above world market prices. Indeed, in 1984, the world price for wheat was $2.10 per bushel while the U.S. price was $3.53. By restricting any decline in prices, agricultural programs have caused U.S. commodities to become uncompetitive in international markets, thus reducing U.S. farm sales abroad. Consumers and tax-

payers bear the cost of these farm programs through increased taxes and higher food prices. Third, most of the benefits of agricultural programs accrue to owners of large farms. Half of direct federal payments in agriculture go to only 15 percent of farmers, generally the largest ones. If current funding policies continue, taxpayers will spend another $52 billion over the next four years supporting approximately 800,000 farmers.

Recent Agricultural Performance

Numerous economic and political factors are cited as recently having an adverse impact on American agriculture. High interest rates, the high value of the dollar, trade embargoes, unfair trade practices by our competitors, declining farm values, widely fluctuating commodity prices, and commodity prices below the cost of production have all been named. The inability of a larger than usual number of farmers to meet debt obligations is offered as evidence that the combination of these factors and the U.S. government's price support policies are leading to the ruin of American agriculture.

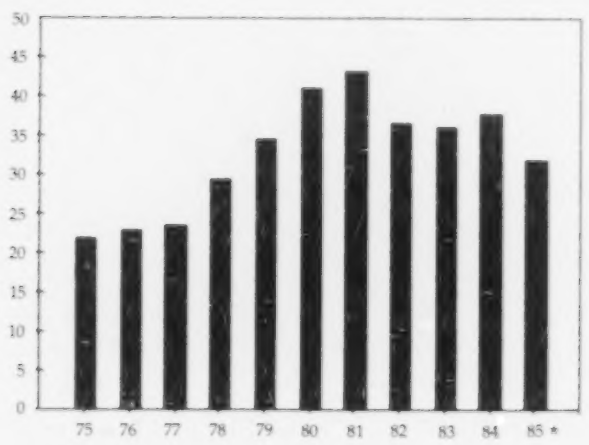
To begin to understand the problem, let us review what has happened to American agriculture over the last decade. In the 1970s, global economic growth, a depreciating dollar, changes in the Soviet import policy, and several crop failures around the world, contributed to more than a fivefold increase in U.S. agricultural exports (see Chart 1). The volume of world agricultural trade grew by 45 percent, while global farm production grew by only 24 percent. These conditions, together with accelerating inflation, dramatically raised U.S. farm incomes. At the same time, expectations of higher inflation and low real interest rates, provided the incentives for huge investments to expand the productive capacity of U.S. farming and agribusiness. As a result, total U.S. farm debt rose from $49 billion to $155 billion and the average price of farmland grew more than threefold during the 1970s. During that period, American agriculture became a capital-intensive, export-dependent sector of the U.S. economy. As a result, it became much more sensitive to interest and exchange rate variability than it had been in the past.

CHART 1

U.S. EXPORTS OF AGRICULTURAL COMMODITIES

($ billions)

1975–1985



*85 – Estimate

Source: U.S. Department of Agriculture

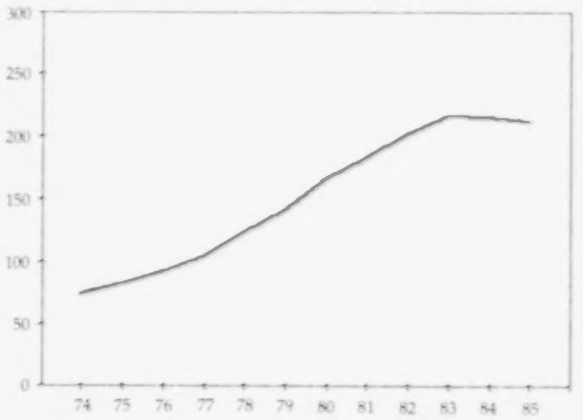
By 1980, American farmers had experienced eight years of unprecedented prosperity. Total farm income rose from $62.1 billion in 1971 to $147 billion in 1979. Commodity prices stayed high and the export value of American crops increased from $7 billion in 1970 to $41 billion in 1980. New and established farmers rushed to expand operations, borrowing heavily to buy land and equipment, and soon found themselves with large debt service bills. Farm debt jumped from $73 billion in 1974 to $212 billion this year (see Chart 2). Interest payments in the farm sector grew sixfold, from $3.8 billion in 1970 to $19.1 billion in 1981. These payments have become the largest agricultural production expense, costing about $22 billion this year. The heavy borrowing was backed by rapidly escalating land prices. Between 1974 and 1981, the average price of farmland in the U.S. rose from $302 an acre to $795. Prime Midwestern land shot up to $4,000 an acre.

CHART 2

TOTAL FARM DEBT

($ billions)

1974–1985



Source: U.S. Department of Agriculture

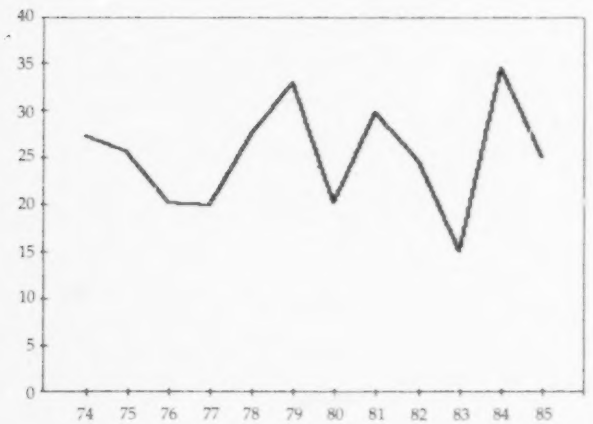
After 1981, two recessions, bumper crops around the world, and the rising dollar made it increasingly difficult for U.S. agriculture to compete. The speed with which market conditions changed in the early 1980s rendered adjustments within the agricultural sector and in U.S. farm policies difficult to achieve. Those farmers who borrowed too much and paid too much for land in the late 1970s found themselves in difficulty. Because average farmland

prices nationwide have fallen by 12 percent between 1981 and 1984, some highly leveraged farmers now find their loan principal larger than the market value of their land. Since peaking in 1981, land values have declined by as much as 50 percent in Iowa and Nebraska, and by 40 percent in Ohio, Illinois, Indiana, Minnesota and Missouri. The problem was also exacerbated by the Agriculture and Food Act of 1981, which established rigid price supports that tended to price U.S. commodities out of the world market. Thus, farming and agribusiness in the U.S. has been left with substantial excess capacity. The combined effect of these changes reduced the total value of U.S. farm exports by about 15 percent between 1981 and 1984.

Distribution of Farm Debt

Although more than three-fourths of the nation's 2.4 million farmers are not in financial difficulty, the minority most burdened with debt is dragging down more and more rural banks, threatening the viability of the agricultural financial system. Although not all farmers are flirting with bankruptcy, they are, nonetheless, facing much lower incomes (see Chart 3). Indeed, an Agriculture Department survey released in July concluded that 50 percent of all farm operators had negative cash flow in 1984. Yet, most of them were able to stay in business by selling assets, or borrowing more. All farm operators, including those with no debt, will realize only $22 billion to $26 billion in net farm income this year, down from $34.5 billion in 1984. According to another study by the Department of Agriculture, only 6.5 percent of all farmers are actually insolvent or on the verge of bankruptcy.

CHART 3
NET FARM INCOME
($ billions)



Source: U.S. Department of Agriculture

Farmers with negative cash flow and an already high debt burden are of particular concern. (These are the farmers who borrowed extensively during the 1970s.) The Department of Agriculture estimates that eight percent of all farmers have debt-asset ratios over 70 percent. This group owes 29 percent of outstanding farm debt. Another 11 percent of farmers have debt-asset ratios of 40 to 70 percent. Most analysts point to farmers operating with debt to asset ratios greater than 40 percent as the group most susceptible to financial stress. But, over 80 percent of all farms have a debt-asset ratio of less than 40 percent, generally indicating a strong financial position.

The Southeast, Southern Plains, Pacific, and Cornbelt regions have the largest share of debt owed by farmers with debt-asset ratios over 70 percent. These regions also have the largest proportion of technically insolvent farmers. This is not surprising since these areas, with a large number of grain, livestock, and dairy farmers have the largest share of medium-size farmers, and experienced the steepest drop in farmland values in 1984.

The Credit Crunch

Although financial stress may persist for only a minority of farmers, the huge overhang of debt will continue to burden the farm sector. In recent months, the financial problems have spread beyond the small, rural commercial banks which have been the principal providers of short-term operating loans to farmers to other major lenders such as the Farm Credit System, Farmers Home Administration, individuals, and the Commodity Credit Corporation (see Table 1).

TABLE 1
DISTRIBUTION OF FARMERS' DEBT BY LENDER
(percent)
January 1, 1985

Lender	Type of Debt: secured by real estate	Type of Debt: not secured by real estate	Total
Commercial Banks	11.7%	16.5%	28.2%
Federal Credit System	26.2	8.7	34.9
Farmers Home Administration	9.7	3.8	13.5
Commodity Credit Corporation	0.2	1.2	1.4
Individuals	10.0	4.3	14.3
Others	4.2	3.5	7.7
TOTAL	62.0	38.0	100.0

Source: Financial Characteristics of U.S. Farms, January 1985, U.S. Department of Agriculture

Farm financial stress has affected the performance of the nation's farm banks—banks with more than a fourth of their loans in agriculture. Loan losses at these banks at the end of 1984 were four times larger than in 1980. The Federal Deposit Insurance Corporation's (FDIC) problem bank list includes 402 farm banks as of September, up from 371 in June. Forty-three of the 81 banks that have failed so far this year were agricultural banks. Iowa, Kan-

sas, Minnesota, Missouri, and Nebraska account for more than half the national total of such potentially vulnerable agricultural banks. And, in South Dakota and Nebraska 70 percent of banks have more than half their loans tied up in farming.

The Farm Credit System (FCS), a federally-sponsored nationwide network of 37 farmer-owned banks and hundreds of cooperative associations specializing in long-term farm real estate lending, disclosed that about 19 percent of its loans are in trouble. The system holds over 34 percent of the nation's $212 billion of farm debt, ranking it ahead of commercial banks (28 percent) as agriculture's largest creditor. The FCS, funded with $73 billion of debt securities owned by insurance companies, banks and investors, estimated this year's losses at $400 million, up from $260 million in 1983. The system's earnings have plunged by 50 percent over the past few years, and last year its Production Credit Associations sustained their first overall loss in 50 years. FCS officials have recently requested a federally-directed rescue.

The Farmers Home Administration (FmHA), an agency of the Department of Agriculture, with nearly $25 billion in outstanding loans, holds about 15 percent of the nation's farm debt. In June, $5.8 billion, or over a quarter of its loans were "delinquent"; $3 billion of them were more than 3 years overdue. The agency is signing up many first time borrowers sent by banks that will not refinance former customers. As a result, the FmHA has allotted more funds for loans, partly with money originally to be lent out later this year.

Although farm banks, the FCS and the FmHA are likely to have more loan delinquencies and loan loss problems throughout this year, it is important to keep the situation in perspective. There is no compelling evidence that the commercial banking system or the federal agencies are in jeopardy. To the contrary, evidence suggests that most agricultural lenders have enough resilience to ride out the current period.

Conclusion

American agriculture is in the midst of a difficult but necessary adjustment. The current and prospective financial problems resulting from adjustment to slower world economic growth, increased international competition, and greater price stability are putting farmers and their lenders under stress. It is important that this adjustment to rapidly changing economic conditions be completed without rupturing the social and political fabric of the nation's rural economy. The challenge for all those involved in the agriculture sector is to use both private and public sector mechanisms to develop a *long-term* solution to the current farm problem.

Currently, the choices confronting U.S. agriculture are either reduced government intervention and increased reliance on market forces to determine farm prices, or still further dependence on government attempts to bring supply and demand into balance through costly supply control and export subsidy programs. Clearly, an economic environment in which farmers are provided the opportunity to seek profitability in a dynamic and expanding marketplace is an environment consistent with the best interests of consumers and of all segments of the agricultural sector. Traditional policies that keep domestic prices above world prices and maintain excessive levels of production must be abandoned. In their place, flexibility must be introduced to keep U.S. products competitive in changing world markets.

WILL ANOTHER BUDGET RESOLUTION BE BROKEN?

by
*William P. Orzechowski and Cesar V. Conda**

To hear our Congressmen talk, one might get the impression that fiscal responsibility is Washington's number one concern. With all the congressional hand-wringing over deficits and lavish federal spending, one might think that Congress was really set to do something about runaway federal spending. Think again, Congress is up to its old tricks. Most of the domestic spending reductions contained in the 1986 budget resolution are in the process of being evaded. The pattern is a familiar one—talk tough and then do nothing.

The recently passed budget resolution proposes to reduce the deficit by $56 billion in fiscal year 1986 and $277 billion over the next three years. Defense spending reductions and minor revenue increases comprise over 50 percent of the proposed savings in fiscal year 1986. Unlike the Senate's original plan, the compromise budget fails to incorporate important structural changes such as a freeze on Social Security and other retirement cost-of-living adjustments, and a wide range of program terminations. Instead, the compromise budget substitutes mild spending freezes and loosely defined spending reductions for the hard programmatic spending cuts in the Senate's original budget.

A short summary of how the congressional budget process works will be helpful in understanding how so many good intentions can slip between the cracks. The congressional budget resolution sets limits on outlays and revenues for the coming fiscal year which begins on October 1. Total government spending is divided into budget functions such as defense, agriculture, and transportation. The budget resolution sets aggregate spending levels for each of the 21 budget functions. The congressional

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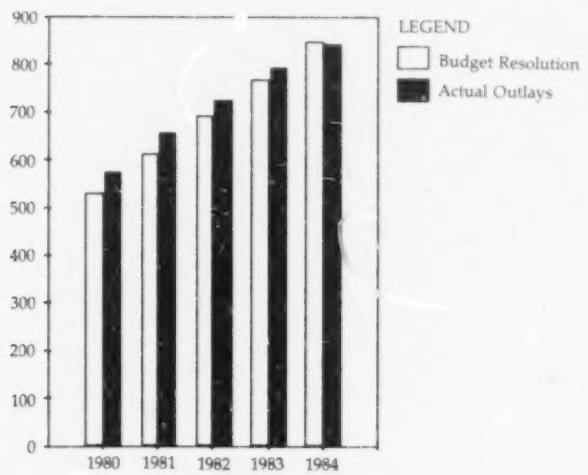
authorizing committees are responsible for the substantive legislation that guides the spending in each federal program. The congressional appropriations committees determine the level of spending for each federal program. These committees are required to make sure that programmatic spending conforms to the limits set forth in the budget resolution.

One of the few redeeming aspects of this year's budget plan is that it "reconciles" 70 percent of the proposed nondefense spending reductions over three years. Reconciliation instructions enforce the budget resolution by directing the congressional authorizing committees to make the changes in laws, bills, and resolutions required to conform with the binding totals, set forth in the budget resolution, for budget authority, revenues, and public debt. Reconciliation is supposed to give teeth to the budget resolution. But recent developments in the appropriations process indicate that total spending plans now incorporated in the appropriations bills, combined with spending under the jurisdiction of the congressional tax-writing committees, will exceed the budget resolution's outlay limits by a substantial margin. In other words, Congress is in the process of violating the already watered-down budget resolution that it just adopted.

Poor Track Record for Budget Resolutions

Preliminary estimates of this year's spending bills indicate that they will breach the outlay ceilings set forth in the budget resolution. This is not surprising given the poor track record of past budget resolutions in controlling federal expenditures. The Impoundment and Budget Control Act of 1974 created the budget committees, budget resolutions and the reconciliation process. Proponents believed that they had created an effective mechanism for budget control. However, federal spending has more than tripled – from $267 billion in 1974 when the law was enacted, to $950 billion in 1985. In the past five fiscal years, Congress has surpassed its own budget resolution by an average of $28 billion a year (see Chart 1). Although actual outlays remained just within the resolution's targets in fiscal year 1984, this by no means suggests that Congress has regained budget control. This year, actual outlays, based on the latest Treasury Department estimates, are running about $6 billion over the 1985 budget resolution's target.

CHART 1
FIRST BUDGET RESOLUTION VS. ACTUAL OUTLAYS
($ billions)



Source: Congressional Budget Office

Errors in forecasting business cycles and the consequent changes in income support programs, such as unemployment insurance, account for some of the overruns in each year. However, since variations in economic activity tend to offset one another, the five year average of $28 billion is due mostly to the congressional bias toward higher spending and the weak enforcement provisions of the 1974 Budget Act. Congress is now agonizing over $22 billion of domestic spending reductions knowing full well that it will likely fritter away more than half of these savings in the appropriations process with deceptive budget techniques. Some of the more popular techniques to conceal spending include the following:

- *Underestimating program costs* – Special interests must deal with the charge that their spending program would "break the bank" and breach the budget resolution's targets. In response, unreasonably low cost estimates are employed to keep programs within the resolution's target. However, supplemental, or additional funding beyond the amount set at the beginning of the fiscal year, is required later in the year when the higher-than-expected program costs begin to emerge.
- *Underfunding a mandatory program* – Congress often agrees to cut funds from a federal program but refuses to enact the changes in law that would make the cuts possible. Consequently, funding runs out later in the fiscal year and supplemental funding is required by law to sustain the program.
- *Fund transfers* – The illusion of budget cuts is sometimes achieved by transferring funds from one government account to another and counting the transfer as a spending cut.
- *Out-year spending reductions* – The resolution's targets can often be avoided by planning for reductions in out-year spending. These "savings," however, tend to disappear by the end of the year in question. Congress can simply restore spending because the resolution's out-year targets are nonbinding and subsequent budget resolutions often overturn changes made in the past.
- *Postponing payments* – Phony budget cuts are often achieved by postponing payments made at the end of one fiscal year to the beginning of the next fiscal year.

This Year's Appropriations Bills are Over Budget

So far, this year's progress on the budget is following a familiar pattern. The House has completed action on ten of the 13 appropriations bills and, in the process, has failed to enact over half of the budget resolution's proposed domestic spending reductions. Either through outright disregard of the resolution's ceilings, or through deceptive budgeting, Congress is breaking its own budget. Indeed the violations have become so flagrant that Congress has had to keep some of these spending bills from reaching the floor. An amendment by Representative Gradison (R-OH) that would have brought the Ways and Means Committee spending bill within budget was submitted to the House Rules Committee. The Gradison amendment prompted the Rules Committee to send the bill back to Ways and Means with a recommendation to propose more reasonable spending levels before allowing the bill on the House floor.

Another example is the House agriculture authorization bill which sets U.S. farm policy for the next five years. As currently drafted, the legal requirements for farm programs in the bill will necessitate spending far beyond the limits incorporated in this year's budget. The major cause of this overspending is the use of outdated estimates of farm crop prices. In determining the level of funding for agricultural price supports and deficiency payments, the committee used the January farm crop price estimates assumed in the budget resolution. However, since crop prices have dropped in recent months, spending for price supports will be much higher. Using recent crop prices, the Department of Agriculture estimates that the agriculture bill will exceed the budget mark set by the budget resolution by approximately $5 billion in fiscal year 1986 and $16 billion over the next three years. The Agriculture Committees are fully aware of this problem, but refuse to incorporate the new crop estimates claiming that the January estimates assumed in the budget are binding on appropriations.

If this were not bad enough, the agriculture committees have employed other methods to subvert the budget process. For example, $3.3 billion in budget savings over three years will be achieved by postponing advanced deficiency payments after October 1 of each fiscal year. All this does is slightly delay the pay-out of agriculture subsidies in order to shift payments into the next fiscal year. The House Agriculture appropriations subcommittee intentionally underfunded a mandatory program by transferring $39 million from Food Stamps to another agricultural account and counting the transfer as a cut in Food Stamps.

The use of budgetary gimmicks is not confined to agricultural spending. In the House-passed Energy and Water Appropriation Bill, a spending cut of $217 million for energy supply research and development was assumed by transferring $217 million of balances to other accounts. In the House-passed Housing and Urban Development appropriations bill, the subcommittee underfunded by $1.1 billion the mandatory General Revenue Sharing Program and used these funds to increase discretionary programs. Supplemental funding will be required later in the fiscal year. The pending House Labor/Health and Human Services/Education appropriations bill underfunds several programs within the bill by at least $2.3 billion. This is achieved by deferring action on appropriations for the programs awaiting authorizing legislation and providing insufficient funds for student financial assistance programs under current law.

Fiscal discipline is fading in nearly every area of the budget. The Senate Budget Committee has estimated that the ten House-passed appropriations bills, excluding farm support payments, have breached the 1986 budget resolution by a total of $4.2 billion. Further, domestic spending programs within the jurisdiction of the House Ways and Means Committee are almost $1 billion over budget. In addition to the $5 billion overage in the farm bill, this brings the 1986 budget evasion total to over $10 billion. With the $100 billion plus Labor/HHS/Education bill yet to be considered, Congress will easily squander over half of the $22 billion in domestic budget cuts planned for fiscal year 1986. Moreover, the Senate has historically tended to add more spending to the House's appropriations bills.

Future Strategies to Control Spending

In the short term, there remain only two opportunities to directly enforce the budget resolution. One method is to offer amendments to appropriations bills to reduce spending for programs that substantially exceed the budget resolution's ceilings. However, recent efforts to reduce overspending through amendments offered on the floor have failed miserably, particularly in the House. An amendment by Representatives Michel (R-IL) and Olin (D-VA) that would gradually lower dairy price supports and save $1.2 billion over four years was defeated 244 to 166. Amendments offered by Representative Frenzel (R-MN) to reduce overspending in the Interior Appropriations bill and the Treasury/Post Office appropriations bill were also defeated by large majorities. An amendment offered by Representative Gradison to strike excessive Ways and Means-related spending was never granted a rule to be considered on the floor. Clearly, Congress does not possess the will to cut spending.

The second and more effective strategy would be for the President to veto spending bills. The Administration has suggested the possibility of using the Senate's original budget resolution targets as benchmarks to trigger a presidential veto. The Senate's targets are considered tougher than those contained in the budget resolution that ultimately passed both houses. Critics of this strategy charge that since both the House and Senate overwhelmingly approved the budget resolution, the President has no grounds for a veto and that such a veto would be easily overturned. However, a group of House members have gathered together the number of members required to

sustain a presidential veto of any spending bill that is not consistent with $56 billion in real spending reduction.

Since the enactment of the Budget Control Act of 1974, Congress has been reluctant to accept changes to the budget process that would strengthen fiscal discipline. However, Senators Gramm (R-TX), Rudman (R-NH), Hollings (D-SC), and Boren (D-OK) have introduced an innovative proposal to be attached to the bill to raise the debt ceiling, that would reform the budget process and balance the budget by 1991. As of this writing, the Senate has passed this proposal to strengthen the budget process and reduce the deficit. The Balanced Budget and Emergency Deficit Control Act of 1985 would require a graduated reduction of federal budget deficits by setting deficit targets in each of the next four fiscal years starting at $180 billion in fiscal year 1986 and ending with a balanced budget by fiscal year 1991. Each year, the President would be required by law to submit a budget that does not exceed the maximum deficit target and the Congress would report a budget resolution that also does not exceed the maximum deficit. When the budget resolution is considered on the House and Senate floors, any amendments to the resolution that increase spending must be compensated by spending reductions elsewhere or explicit tax increases. At the start of the new fiscal year, if estimated deficits are greater than the deficit target, the President would be required to cut federal spending across-the-board by a uniform percentage to eliminate the deficit overage.

The Gramm-Rudman-Hollings-Boren bill is a temporary plan to balance the budget by fiscal year 1991. Permanent restraints on Congress' ability to tax and spend can only be achieved by enacting a constitutional balanced budget/tax limitation amendment.

Summary

This year's budget resolution is in the process of being whittled away. As of this writing, most of the spending bills that have passed either the House or the Senate exceed budget limits. Nevertheless, hope springs eternal. The latest public opinion polls indicate that the budget deficit remains a major concern of the American people. With continued public pressure, there is a good chance that efforts to strengthen the budget process may pass Congress and the President may actually exercise his veto powers.

1985: THE YEAR OF THE VAT?

by
*Terree P. Alverson**

The probability is high this year that the United States will enact a value-added tax (VAT) for the first time in its history. Proposals for VATs have appeared in both houses of Congress, and one bill has already passed the Senate Finance Committee. These value-added tax plans have appeared under the guise of comprehensive tax reform and within the Superfund toxic waste program.

Senator Roth (R-DE) has introduced the Business Transfer Tax (BTT), a form of the value-added tax, which will tax each manufacturing stage of a product, but which will essentially function as a tariff on imports because of offsets. The Senate Finance Committee has reported out a value-added tax called the Manufacturers' Excise Tax (MEET) to finance the Superfund program by taxing manufacturers with sales over $5 million.

The European Experience

The European community has had considerable experience with the value-added tax. Since 1957, all members of the European Economic Community have instituted VATs to increase government revenues. Most countries have various rates for different items, and most exempt certain necessities, such as food or medical care, from taxation.

The European experience has revealed some problems associated with VATs. Administrative costs for business are high, as each transaction must be documented and tax returns submitted on a regular basis. Government costs also increase, as the number of regulations issued to clarify the law rises. Problems with evasion and black marketeering of goods are more serious than originally anticipated.

The most common argument given by opponents of the VAT is that it is a hidden tax, and because of that, it is easier to raise the rate to accommodate increased government spending. The European experience may validate this claim; rates there have risen between 15 percent to 35 percent, depending on the item taxed.

Tax Reform

Both Congress and the Administration have deemed static revenue neutrality a prerequisite for overall tax reform. Many of the principal reform proposals stand accused of falling short of the revenue mark, and the juggling act has begun to insure that the final reform plan meets this requirement. To date, these attempts have proven unsuccessful. Recently, Senator Roth, partly in response to the revenue neutrality problem, introduced a Business Transfer Tax (BTT), which could be used along with comprehensive tax reform to lower individual rates while retaining revenue neutrality. Other members of the Senate Finance Committee have also expressed interest in the BTT or some other form of a value-added tax.

Senator Roth considers the inclusion of the BTT (S.1102) as the best way of achieving revenue neutral reform that

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is less biased against savings and investment. He has emphasized that his proposal is a substitute for lower tax rates and improved investment incentives, not a revenue raiser.

Under the proposal, every manufacturer will be subject to the BTT. Tax liability will be calculated by totalling gross receipts and subtracting purchases of raw materials and other inputs. Salaries, interest payments, and dividends, however, will not be subtracted from the tax base. The rate of tax will be five percent on the "value added."

The BTT includes a provision under which each firm can use its tax liability as a credit against its FICA payroll taxes. These credited amounts will be transferred directly to the Social Security Trust Fund. However, no firm could escape its FICA tax liability. If the BTT generates insufficient revenues the firm must still pay the FICA tax. While goods destined for export will be excludable from the tax base, the tax would be assessed on the full price of imports. At the five percent level, the BTT with the FICA credit is estimated to raise approximately $20 billion a year. The bulk of the revenue raised—$17 billion—will be generated by the tax on imports, with only the remaining $3 billion coming from domestic producers.

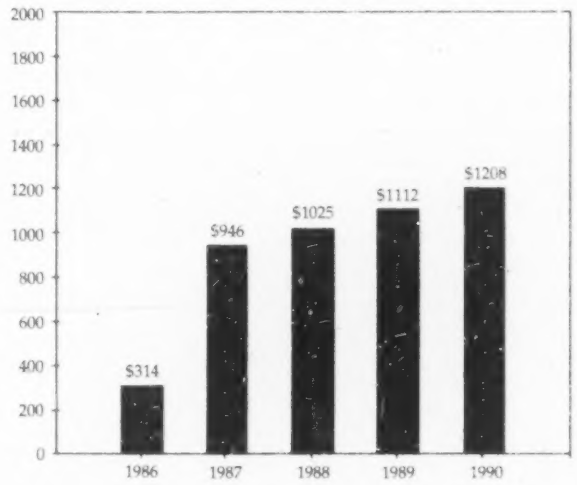
In early October, Senator Roth introduced another version of the BTT. This new version will eliminate the FICA credit and allow the BTT to be fully deductable from either the corporate or individual income tax. The tax rate is raised to between eight percent and ten percent. Revenues from the tax would be used to offset revenue losses resulting from lower individual and corporate marginal tax rates, improvements in the capital cost recovery system, lower capital gains tax rates, and increased IRA contributions.

Congress is currently reauthorizing Superfund, the program to clean up toxic waste sites, whose five-year funding of $1.6 billion expires this year. Early indications are that Congress will raise the fund's level to somewhere between $7 billion and $10 billion—a five- to tenfold increase in funding. To ease the burden on petroleum and chemical companies, who now shoulder approximately 80 percent of the tax burden, both houses of Congress are showing interest in a VAT to finance the additional amount.

The Superfund Excise Tax or Manufacturers' Excise Tax would impose a new tax on all manufacturers with sales over $5 million ($10 million in the House version). The Senate Finance Committee recently approved a version of this tax, known as S.51. Under the S.51 formula, a tax rate of 0.08 percent applies to the sales price of, or gross lease payments for, tangible personal property in connection with a trade or business. The bill provides for a tax credit on purchases of property allocable to the cost of manufacturing goods. Imports are taxed at the border and exports are exempted.

Manufacturers would be required to file a new Superfund Excise Tax Return at the same time they file their regular tax returns, and to deposit funds quarterly. The amount of anticipated revenues as a result of the Superfund Excise Tax are shown in Chart 1.

CHART 1
SUPERFUND EXCISE TAX REVENUES
($ millions)



Advantages and Disadvantages

The outcome of these proposals is uncertain as several factors may work to defeat the passage of a VAT this year. The Reagan Administration is opposed to it and views any VAT as a tax increase. Many members of Congress, who recall the defeat of Al Ullman (D-OR), possibly due to his advocacy of the VAT, are hesitant to offer support. And economists and academicians have criticized some of the VAT's possible effects on the economy and the rate of growth in government spending.

Nevertheless, the VAT has some politically attractive features which could prove irresistable to Congress. It is a tax which is added on at each stage of the manufacturing process and thus, becomes embedded in the cost of a product. This distinguishes it from a sales tax, which is added directly at the retail level as a separate cost easily identified by the consumer. A hidden tax, such as the VAT, is politically attractive, as consumers are not aware of how much tax they are paying, and as a result, it becomes easier to raise the rate without public opposition. And once the administrative apparatus is in place, it is easy to raise the rate with little additional political and financial costs.

Because the VAT is levied on a very broad base, incremental increases in the rate raise large amounts of revenue, a decided advantage for our elected representatives. As a result, many are concerned that the VAT would become an easy vehicle for solving the budget

deficit problem without having to raise highly visible taxes or reduce government spending.

Although most Western European countries employ VATs, the U.S. has previously avoided such a tax because of many perceived disadvantages and criticisms. The major criticism levied on the VAT is that it is a hidden tax, and the rate is too easily raised. This is witnessed by Europe's experience with ever-increasing VAT rates, some now above 20 percent. Critics fear the opening of a Pandora's box with the enactment of a VAT in the U.S.

Since many European countries do employ a VAT, it has been suggested that it would be to the U.S.'s trade advantage to adopt one as well. Because the tax is levied on imports and not exports, it is, at times, recommended as a less harmful revenue raiser that would offset import taxes paid by U.S. exporters as their products enter other countries.

The current income tax system encourages consumption by raising the cost of saving and investing. A consumption-based tax like a VAT, however, removes the bias towards consumption, leaving the choice between savings, investment and consumption neutral.

Many analysts have noted that, unless certain exemptions are made for essential items such as food, the VAT like other consumption-based taxes, is a regressive tax. On the other hand, others note that once exemptions are allowed, the tax becomes complicated to administer and loses its revenue raising ability.

Senator Roth's original proposal is structured so that at a low rate (currently set at five percent), the tax would offset a company's FICA liability only, and not require any increase in tax payment. Therefore, at such a low rate, the majority of revenue from the BTT would result from a tax on imports. It has been suggested that this would make the BTT primarily an import tax and could be viewed as a protectionist measure. Such a tax increase would raise import prices and reduce foreign sales in the U.S., lowering foreign profits. This would reduce the ability of other countries to purchase our exports, and possibly exacerbate our trade deficit. In addition, if the tax rate were raised above the FICA liability level, more revenues would flow from domestic business, resulting in higher prices for American goods purchased domestically.

Senator Roth asserts that the BTT will reduce the FICA bias against labor, leading to the creation of new jobs. This may prove to be an advantage to small businesses, who are relatively more labor-intensive. However, to the extent that it remains a tax on business (especially as the rate rises), it reduces profits, and could be perceived as a tax increase on capital formation by encouraging the hiring of labor over capital investment in some cases.

Senator Roth's bill demands the BTT be used in conjunction with overall tax reform to offset any revenue loss from lower individual marginal rates. However, because corporate taxes are paid by individuals, visible tax payment made through the personal income tax would be replaced under the BTT by hidden taxes paid by individuals through the mechanism of the corporate income tax.

Conclusion

The success or failure of a VAT probably depends on three developments: (1) the passage of an increased Superfund bill that includes the Manufacturers' Excise Tax, (2) the passage of a comprehensive tax reform package, or (3) significant long-term deficit reduction by the Congress. The Superfund Excise Tax has been accused of allowing the "camel's nose under the tent." Many have expressed concern that once a VAT is in place, even though initially limited to one program, it will not be long before it is expanded. Congress has, in the past, seemed unable to pass *significant* budget reductions and is continually faced with massive deficits, so the potential for continued tax increases exists. In the short-term, a BTT might appear as part of comprehensive tax reform (in exchange for lower marginal rates), or in the long term, it might be enacted separately as an additional tax, as a politically convenient method for deficit reduction.

TRENDS IN COMMERCE NOTES ON TABLE II OCTOBER, 1985

by
Martin Lefkowitz

Gross National Product (GNP)–The Department of Commerce's "flash" estimate of the nation's economic performance as measured by Gross National Product–the value of the output of goods and services–anticipates that the inflation-adjusted growth rate for the third quarter will be 2.8 percent. This is an improvement from the second quarter when the economy grew at a revised 1.9 percent annual rate and a real boom compared to the 0.3 percent growth rate of the first quarter. Personal consumption expenditures and government purchases are expected to account for most of the third quarter increase. Residential and business investment, both of which were growing rapidly in the second quarter, are expected to show little change, while inventories should continue to decline. Net exports are also expected to remain at about the same level as during the second quarter.

The Services Sector–Employment in service sector establishments rose by 0.3 percent in September and is now 4 percent above its year-ago level. This compares

with a 0.3 percent decrease in employment in the goods producing sector in September, and a 0.4 percent increase from last year.

August witnessed a reversal in the trend toward rising purchases of consumer services relative to consumer goods. Purchases of durable goods increased by 6.5 percent, compared to a relatively small 0.6 percent increase in services. August data also indicate that purchases of goods, before adjusting for inflation, were up 7.3 percent from their level of last year, while purchases of services rose by 8.9 percent during the same period. Consumer purchases of services now comprise 50.7 percent of personal consumption expenditures compared to 50.4 percent in August 1984. Major domestic airlines reported that revenue passenger miles flown, that is, the number of passengers multiplied by the miles flown by each passenger, hit a record 30.9 billion revenue passenger miles, an increase of 11.9 percent from last year. The previous record was set in July when 30 billion revenue passenger miles were flown. For the first eight months of 1985, major U.S. carriers reported a 13 percent increase in revenue passenger miles flown from the same period in 1984.

Money Supply—The nation's money supply—as measured by M-1, currency in circulation plus demand deposits—increased by 1.7 percent from July to August. The money supply has been growing at a 16.8 percent seasonally adjusted annual rate in the latest three-month period, and a 12.9 percent annual rate for the last six months. This is far above the Federal Reserve's target range of four to seven percent.

Employment—The civilian unemployment rate dipped to 7 percent in August, and then inched back up to 7.1 percent in September. The small September increase in the unemployment rate is the result of a surge of new entrants into the labor force rather than job losses. Civilian employment—as measured by the monthly survey of households—increased by 372,000 persons (seasonally adjusted) following an increase of 310,000 from July to August. The number of nonagricultural payroll jobs—as measured by the monthly survey of business establishments—increased by 128,000 in September, reflecting an across the board gain, including an increase in manufacturing jobs.

Prices—The Consumer Price Index for all urban consumers (CPI-U) increased a meager 0.2 percent in August for the fourth consecutive month. The slowdown in the rate of growth of consumer prices that occurred in the last four months reflects lower prices for used cars, energy, and foods, all of which had registered price increases in the first four months of the year. These lower prices partially offset the acceleration in shelter costs, which rose at an 8.1 percent annual rate in the latest four months, and medical care costs, which have been increasing at a 7.8 percent annual rate. Consumer prices have been increasing at an annual rate of 3.3 percent in 1985 compared to 4 percent for all of 1984. The pace of increase in consumer prices slowed to a 2.4 percent annual rate in the latest three month period, significantly below the 4.1 annual percent rate experienced in the first quarter.

Wholesale prices of finished goods fell 1.1 percent in September and were up 0.2 percent from their year ago level. The index for energy prices was down for the fourth consecutive month after substantial increases in April and May. Consumer food prices showed a 0.9 percent decrease in September, after falling 0.7 percent in August. The index for consumer goods other than foods and energy fell 0.5 percent, after showing no change for a month earlier. Most of the September drop was due to a 3.8 percent decrease for passenger cars and a 2 percent decline in light motor trucks.

Crude goods prices edged down 0.3 percent in September, far less than the 2.4 percent decrease in August. A slower rate of decline for many foodstuff items was chiefly responsible for this smaller decrease. Crude food prices fell 0.7 percent in September following a 3.8 percent drop in August. Prices of crude energy materials rose 0.4 percent, after falling 0.9 percent in August. The prices of crude nonfood materials, other than energy declined 0.6 percent.

Housing Starts—Privately owned housing units were started at a seasonally adjusted annual rate of 1,749,000 in August, six percent above the July level. Building permits, an indicator of future activity in the home building industry, increased four percent in August and were 14 percent above year-ago levels, indicating that housing starts will probably continue to increase over the next few months. In addition, household formations, which had slowed in the last recession, appear to be on the rise again, indicating a potential increase in the demographic demand for new housing units.

Industrial Production—August data showed a 0.5 percent increase in manufacturing output and a 0.3 percent increase in total industrial output. The August increase in manufacturing output showed gains in virtually every sector for the first time since last March. The automotive sector registered its strongest gain in August partly due to increased output of light trucks. Output of defense and space products continued to register strong gains, up 0.9 percent in August and nearly nine percent from August 1984. Business equipment output also increased 0.2 percent in August following three months of declines. Construction material output continued to increase in August.

The capacity utilization rate in manufacturing was up 0.2 percent in August to 80.2 percent. Motor vehicles, aerospace and miscellaneous transportation, and petroleum products industries all showed the largest gains in utilization rates. Despite unfounded rumors of an ending

TABLE II
TRENDS IN COMMERCE

	Current Period		Previous Period	Year Ago	Percent Change From Previous Period	Percent Change From Year Ago
Population (Millions) [a]	Jul/85	239.0	238.1	236.9	0.4	0.9
Gross National Product ($B)	III/85	3,909.4	3,853.1	3,694.6	1.5	5.8
Gross National Product (72$B)	III/85	1,683.0	1,671.3	1,645.2	0.7	2.3
Money Supply (M1) ($B)	Aug/85	606.0	595.8	548.9	1.7	10.4
PEOPLE AND THEIR MONEY						
Personal Consumption Expenditures ($B)	Aug/85	2,541.5	2,510.4	2,350.1	1.2	8.1
Personal Consumption Expenditures (72$B)	Jul/85	1,104.9	1,101.6	1,066.1	0.3	3.6
Disposable Personal Income ($B)	Aug/85	2,713.7	2,708.8	2,605.4	0.2	4.2
Disposable Personal Income (72$)	Jul/85	1,192.2	1,187.8	1,174.3	0.4	1.5
Personal Savings Rate (%)	Aug/85	2.8	3.8	6.7	−1.0[b]	−3.9[b]
Civilian Employment (millions)	Sep/85	107.5	107.2	105.4	0.3	2.0
Civilian Unemployment Rate (%)	Sep/85	7.1	7.0	7.4	0.1[b]	−0.3[b]
Average Hourly Earnings	Sep/85	$8.64	$8.59	$8.40	0.6	2.9
Consumer Price Index (All Urban, 67 = 100) [a]	Aug/85	323.5	322.8	312.9	0.2	3.4
Purchasing Power of the Dollar (67 = $1.00) [a]	Aug/85	0.310	0.310	0.320	−0.186	−3.22
Prime Interest Rate (%) October 2, 1985		9.5	9.5	12.75	0.0[b]	−3.25[b]
Retail Sales ($)	Sep/85	120.3	117.0	108.4	2.7	10.9
SERVICES SECTOR						
Employment in Services (Millions)	Sep/85	73.2	73.0	70.4	0.3	4.0
Consumer Purchases of Service ($B)	Aug/85	1,288.9	1,281.6	1,183.4	0.6	8.9
Consumer Purchases of Service (72$B)	Jul/85	512.1	511.4	493.6	0.1	3.7
Revenue Passenger Mileage Flown Major Airlines (Billions) [a]	Aug/85	30.9	30.0	27.6	5.3	14.7
BUSINESS PROFITS AND OUTPUT						
Nonfinancial Corporate Profits ($B) [a]						
Before Tax [a]	II/85	221.0	222.3	246.0	−0.6	−10.2
After Tax [a]	II/85	137.4	137.0	150.2	0.3	−8.5
Industrial Production (67 = 100)	Aug/85	124.8	124.4	123.5	0.3	1.1
Capacity Utilization Rate (Mfg.) (%)	Aug/85	80.2	80.0	81.8	0.2[b]	−1.6[b]
New Housing Starts (thou. units)	Aug/85	1,749.0	1,647.0	1,590.0	6.2	10.0
Net Business Formation (67 = 100) [a]	Aug/85	119.0	118.0	119.1	0.8	−0.1
New Business Incorporations (Thousands)	Feb/85	54.5	53.3	53.6	2.4	1.8
BUSINESS COSTS						
Unit Labor Costs (nonfarm) (77 = 100)	II/85	164.2	163.3	157.6	0.6	4.2
Unit Nonlabor Costs (77 = 100)	II/85	161.7	100.3	159.5	0.9	1.4
Producer Price Indices (67 = 100)						
Crude Materials	Sep/85	292.4	295.5	326.2	−0.3	−10.4
Intermediate Goods	Sep/85	317.9	317.8	320.3	0.0	−0.7
Finished Goods	Sep/85	290.2	293.5	289.5	−0.6	0.2
FEDERAL SPENDING AND DEBT						
Federal Spending Index (67 = 100)	Aug/85	636.7	594.0	565.7	7.2	12.7
Federal Government Debt Outstanding ($B) [a]	Jun/85	1,779.0	1,758.3	1,517.2	1.2	17.3
INTERNATIONAL TRADE						
Exports of Goods & Services ($B)	II/85	347.7	360.7	362.4	−3.6	−4.1
Imports of Goods & Services ($B)	II/85	441.6	435.2	421.1	1.5	4.9
Balance on Goods & Services ($B)	II/85	−93.9	−74.5	−58.7	26.0	60.0
WHAT'S AHEAD?						
Index of Leading Indicators (67 = 100) [a]	Aug/85	170.1	169.0	164.4	0.7	3.5

NOTES: All data seasonally adjusted unless otherwise noted
[a] Not seasonally adjusted
[b] Percentage point difference

industrial base, our ability to produce continues to increase. Manufacturing capacity rose 0.8 percent in the second quarter of 1985, an increase of 3.3 percent from a year ago.

Productivity—Nonfarm business productivity increased at a 1 percent annual rate in the second quarter, compared to a 3.1 percent decline in the first quarter. The first quarter decline was the most severe since the fourth quarter of 1981, when productivity dropped 4.4 percent. In the second quarter, output in the nonfarm business sector grew by 2 percent as a result of an increase of 1.2 percent in the number of hours worked and a 1 percent increase in productivity.

Interest Rates—At 9.5 percent, the prime interest rate is 3.25 percentage points below the rate at this time last year. Three- and six-month Treasury bill rates at the end of September were virtually unchanged from their levels at the end of August. There was also very little movement in the longer term seven-year Treasury notes and thirty-year bonds during September.

Business Failures and Formations—Dun and Bradstreet's Index of Business Failures indicates that business failures at the end of August were at their highest level in two months. Business failures in the first eight months of 1985 increased by 9.8 percent from their year-ago levels and total business closings were up about 17 percent.

Dun and Bradstreet reported that 105,558 new business corporations were formed in the first two months of 1985, an increase of 1.1 percent from the previous year. Five states had increases of ten percent or more, and six of the nine census regions reported more new business corporations formed in the first two months of 1985 compared to 1984. The Middle Atlantic and Mountain States reported the largest gains while the Pacific region had the steepest decline. The states reporting the largest increases in new corporations in the first two months of 1985 were South Carolina, Louisiana and New Hampshire.

Federal Spending—The "Federal Spending Index," a U.S. Chamber devised measure of the monthly change in federal expenditures, increased 12.7 percent in August from its year-ago level, after adjusting for the fact that two Social Security payments were made in August 1984 because of the timing of the Labor Day weekend. This is nearly four times the rate of increase in consumer prices over the last twelve months. In the first eleven months of fiscal year 1985, federal expenditures increased by 9.2 percent, nearly three times as fast as prices, indicating a real increase in federal spending of about six percent from their year-ago level. Federal receipts, during the same period, have risen by 10.3 percent as a result of double digit increases in personal income taxes, corporate income taxes, and social insurance taxes. The data on tax receipts indicates that federal tax revenues continue to increase at a faster rate than increases in income. The faster growth of taxes and federal outlays than prices or the economy indicates that we must concentrate on expenditure reduction in order to bring the federal deficit under control.

Personal Savings—After a savings bulge which resulted from delayed tax refunds in May and pushed the personal saving rate up to 6.3 percent, consumers went on a spending spree in August. Personal consumption spending rose 1.2 percent for the month, about six times as fast as the 0.2 percent increase in after-tax income. This brought savings down to a lackluster 2.8 percent of after-tax income for August.

Retail Sales—Retail sales increased 2.7 percent in September, following a 2.3 percent increase in August. Durable goods sales rose 6.2 percent in September due to a more than 9.6 percent increase in auto sales from August and a 34.2 percent increase in auto dealers sales from their levels last year. Nondurable goods inched up 0.6 percent in September following a 1 percent increase in August. Department store sales fell 2 percent for the month. However, the combined increase in automotive sales and other consumer durable goods shows a significant revival of consumer confidence in the closing days of summer.

Trade Deficit—The trade deficit continued to grow in the second quarter. On a goods and services basis, the trade deficit increased to $94 billion in the second quarter from $74.5 billion in the first quarter. The deterioration is largely due to a $13 billion decline in exports, while imports increased by $6.4 billion. On a monthly basis, the merchandise trade deficit declined to under $10 billion in August for the first time in 1985. The reduction was mainly the result of reduced imports and a small 0.7 percent increase in exports. Over half of the decrease in the merchandise trade deficit was the result of a lower level of petroleum imports. However, exports of agricultural and petroleum products increased, offsetting the decline of manufactured goods exports.

What's Ahead—The composite index of leading indicators, designed to predict future movements in aggregate economic activity, increased 0.7 percent in August, with seven of the eleven available indicators up, three were down and one was unchanged. This follows a revised 0.7 percent increase for July that was previously reported as a 0.4 percent gain. Most encouraging about the August data was the fact that the three indicators which are related to employment—average workweek in manufacturing, initial unemployment claims and new business formations—all showed improvements. This indicates continued strong job gains in the months ahead.

WANT TO BUY A ROBOT?

The answer to that question is increasingly yes.

According to the Robotics Industry Association, the United States had approximately 6,300 operating robots in 1982. This was less than one-fifth the number of robots operating at that time in Japan. Significantly, 240 of the 6,300 American robots were located in one factory in Smyrna Tennessee, a Nissan truck assembly plant, owned by Nissan Motors of Japan.

During 1983, the robot population of the United States increased by 55 percent to 3,500. This included 2,500 domestically produced robots and about 1,000 imported robots. The Robotics Industry Association reports that in 1984, shipments of the domestic robotics industry were up about 68 percent from its 1983 level to nearly 5,136.

The average robot in the United States currently costs about $64,739 per installation and has a life expectancy of about five to eight years. In addition, there is usually a cost of redesigning the configuration of the workplace which could add substantially to the installation cost.

Presently, the largest users of robots are in the high paying auto industry where compensation costs are currently running about $23.00 per hour. Robots replacing these workers cost about $6.00 per hour to operate. Robots also have other advantages over human workers in that they reduce work environment costs. This is especially true when workers are subject to toxic substances, such as lacquers, asbestos and other toxic and carcenogenic materials. The robots currently being used are eliminating dull, dangerous and dirty jobs.

LAGOS, TOKYO, NEW YORK, ABU DHABI MOST EXPENSIVE CITIES IN THE WORLD

According to a recent survey by the Union Bank of Switzerland, Lagos, Nigeria; Tokyo, Japan; New York City, U.S.A.; and Abu Dhabi in the United Arab Emirates are rated as the four most expensive cities in the world. The following cities ranked next in terms of cost of living: Manama (Bahrain), Chicago, Houston, Jeddah (Saudi Arabia), Oslo, Los Angeles, Seoul, and Helsinki.

The U.S. has become relatively more expensive in the past year because of the high value of the dollar, but salaries have largely kept pace with the increase in the cost of living.

The survey indicates that the best value, in terms of goods and services purchased, occurred in Lisbon, Rio de Janerio, Istanbul, and Bangkok. Taking 12 professional groups as a basis for its calculations, the survey found that the best paid professional workers are in North American and Switzerland.

FOREIGN-OWNED MANUFACTURING FIRMS ARE SPREADING IN THE U.S.

Where do foreign corporations locate their businesses in the U.S.? According to the Conference Board, a New York-based business research group, there were 325 new foreign manufacturing investments across the U.S. last year. The largest number occurred in New York, with a total of 49 new manufacturing investments. California ranked second, with 33; North Carolina, third, with 20; Georgia, fourth, with 17; and Texas, fifth, with 16. New Jersey and Illinois had 15 new foreign-owned investments each. These numbers reflect both U.S. facilities acquired last year by overseas concerns as well as new or expanded plant construction.

The report emphasizes that foreign-owned investment is spreading beyond the industrial belt to other areas of the country as well. For example, the assembly line at Japan's Nissan Motor Company in Tennessee has been turning out small pick-up trucks since 1983. Several other states which have experienced increases in foreign manufacturing investments are Washington, Kentucky, Alabama, and Oregon.

PERSONAL INCOME PROJECTIONS TO THE YEAR 2000

According to projections by the U.S. Commerce Department's Bureau of Economic Analysis, personal income in the United States is expected to increase 2.6 percent per year from 1983 until the year 2000. The states enjoying the largest percentage are projected to be Arizona, Nevada and Utah. Pennsylvania, Illinois and New York are anticipated to have the smallest percentage increases in personal income over the next 15 years.

The 10 states expected to have the largest average annual increases in personal income are: Arizona (4.3%), Nevada (3.9%), Utah (3.8%), Florida (3.5%), Colorado (3.5%), Wyoming (3.4%), Alaska (3.3%), New Hampshire (3.1%), New Mexico (3.1%), and Vermont (3.1%).

Among the 10 states expected to have the lowest average annual increases in personal income are: Pennsylvania (1.9%), Illinois (1.9%), New York (1.9%), Ohio (2.0%), West Virginia (2.0%), Michigan (2.1%), Maryland (2.2%), Iowa (2.2%), Missouri (2.2%), and Delaware (2.3%).

Exchange Value of the Dollar

(WEIGHTED AVERAGE INDEX)